



Jack O'Connell
State Superintendent of Public Instruction

CALIFORNIA
DEPARTMENT
OF
EDUCATION

1430 N Street

P. O. Box 944272

Sacramento, CA

94244-2720

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To: County and District Superintendents
Charter School Administrators

Attention: County and District Chief Business Officers

From: JACK O'CONNELL

Subject: **GOVERNOR'S BUDGET FOR 2003-04**

On Friday, January 10, Governor Gray Davis presented his budget for 2003-04. We distributed a preliminary overview of the budget last week; this bulletin provides more detail on the proposal. Copies of this bulletin, as well as other budget-related documents, are available through the California Department of Education's (CDE) web site (www.cde.ca.gov/fiscal/budgetact/). Official state budget documents are available through the Department of Finance's web site (www.dof.ca.gov/). The Governor's Budget is just the first step in the budget process. The proposals are likely to change significantly before final enactment.

Budget Overview

The budget projects a funding gap of \$34.6 billion. This funding gap represents the difference between projected revenues and projected spending over the two-year period ending with fiscal year 2003-04. The gap is the result of an approved 2002-03 budget that did not address underlying structural imbalances in revenues and expenditures and deteriorating economic conditions. The magnitude of the gap—equal to almost half of projected 2002-03 revenues—is unprecedented.

The budget proposes to address the gap with \$20.7 billion in spending cuts, \$8.2 billion in new revenues, and \$5.7 billion in fund shifts, transfers, and loans. The new revenues are from a 1-cent increase in the sales tax, an increase of \$1.10 per pack in the cigarette tax, and additional tax brackets for high-income taxpayers. The new taxes would be allocated entirely to counties, which would use the revenues to pay for new responsibilities shifted from the state. The realignment proposal affects child development and a number of programs in the health and welfare area. Because counties would receive the new revenues rather than the state, the revenues are not included in the Proposition 98 calculations.

According to the budget documents, the budget as proposed “substantially eliminates the ... structural shortfall between revenues and expenditures.”

Current Year Changes

Under Proposition 98, the revenue forecast generates \$43.9 billion in state and local funds available in 2002-03 for ongoing program purposes in K–12 schools, other educational agencies, and community colleges. This is based on “Test 2” under Proposition 98. The 2002-03 spending level assumed in the budget is \$43.9 billion, which is equal to the Proposition 98 minimum guarantee.

The budget allocates \$39.3 billion of the \$43.9 billion in current-year Proposition 98 spending to K–12 education. The K–12 spending level reflected in the budget assumes that the Legislature will approve significant spending reductions proposed by the Governor. The effect of these proposals would be to reduce K–12 Proposition 98 spending by \$2.2 billion below the 2002-03 enacted budget. (These figures incorporate reductions proposed in December and additional reductions proposed in January.) On a per-ADA basis, K–12 Proposition 98 funding decreases from \$7,067 in the enacted budget to \$6,668, or 5.6 percent.

Including one-time funds that do not count in the Proposition 98 figures, the effect of the budget reduction proposals on K–12 education is around \$1.8 billion.

Proposal for 2003-04

For the budget year, the revenue forecast generates \$44 billion in state and local funds for K–12 schools, other educational agencies, and community colleges, based on Test 3 under Proposition 98. As part of the Proposition 98 calculation, the Constitution allows the state to provide a lower funding level (Test 3) than otherwise required in years when personal income growth exceeds General Fund revenue growth. The Governor’s spending proposals exceed the Proposition 98 minimum guarantee by \$104 million. The \$44.1 billion in spending proposals is an increase of \$182 million above the revised 2002-03 level.

The Governor proposes allocating \$39.9 billion to K–12 schools in 2003-04, which is an increase of \$627 million above the revised 2002-03 level and a reduction of \$1.6 billion below the 2002-03 enacted budget.

On a per-ADA basis, K–12 Proposition 98 funding increases from \$6,536 (revised current-year amount adjusted to be consistent with the realignment proposal) to \$6,708, or 2.6 percent.

The Appendix provides details of the proposed funding changes for both 2002-03 and 2003-04.

Major Budget Proposals for 2002-03

Across-the-Board Reductions

The current-year proposals include a reduction of \$612.4 million (3.66 percent of the General Fund amount and 2.15 percent of the total amount including property taxes) in school district and county office revenue limits. The reductions would be permanent adjustments to base revenue limits. The budget also proposes to apply the 2.15 percent reduction to basic aid districts by reducing basic aid payments.

For categorical programs, the budget proposes across-the-board reductions amounting to \$750.9 million, or 10.82 percent of the General Fund appropriations (3.66 percent reduction proposed in December compounded with an additional 7.46 percent proposed in January). The reductions apply to most but not all programs. Child development is exempt from the reductions. Supplemental instruction and child nutrition are subject only to the 3.66 percent reduction. For special education there is a net reduction of \$21 million; however, there are funds in the 2003-04 budget to backfill the 2002-03 reduction.

The Governor proposes legislation “to provide flexibility to districts in using remaining funds and reserves to manage the effects of these reductions” and “to allow deferred appropriations to be counted for reserve determination purposes in the year for which they are owed.”

Change in Funding Source

The Governor proposes to revert unused appropriations from 2001-02 and earlier years and use the funds to support \$438 million in current-year costs of Regional Occupational Centers and Programs (ROC/Ps) and adult education. A similar funding shift was enacted last February to pay the 2001-02 costs of adult education.

Program Reductions

The package includes several program reductions. The most significant is a proposal to eliminate CalWORKs Stage 3 child care effective April 2, 2003, for a savings of \$98.8 million. Although the budget proposes to eliminate the CalWORKs program in the current year, funds sufficient to fully fund the program in 2003-04 are included in the realignment proposal and are shown in the budget as available to counties for their use in operating child development programs.

The budget proposes to use federal funds to offset the costs of the high priority schools grant program and also proposes to delay expanding the program into a second cohort, for a savings of \$22.6 million.

Redevelopment Agency Transfers

The budget proposes a one-time shift of \$477.2 million from redevelopment agencies to school districts and county offices of education. This proposal increases property taxes available for revenue limits and reduces the General Fund appropriation.

Other Proposals

Other proposals include:

- A reduction of \$27.1 million to align program spending with the fiscal year in which services are provided. In affected programs, funds appropriated in one fiscal year historically have been used to support services provided in the next fiscal year. Consequently, one year of funding can be eliminated without affecting services.
- A reduction of \$13.5 million to reflect the impact of audits on adult education program funding caps.
- A reduction of \$11.4 million to ROC/P appropriations to capture savings resulting from excess property taxes.

Major Budget Proposals for 2003-04

Revenue Limits

The budget proposes to continue the reductions proposed in 2002-03 into 2003-04. The budget funds growth and the 9.5 percent PERS rate increase but does not provide any funds for cost-of-living adjustments. The budget does not propose to restore funds to buy out the PERS offset; this buyout was partially funded in 2001-02 but is not funded in the current year.

The budget proposes to recapture property tax revenues and basic aid payments in cases where a school district's property tax revenue exceeds its revenue limit entitlement.

Finally, the budget includes a total of \$250 million for revenue limit equalization, an increase of \$47 million above the amount already appropriated in the 2002-03 budget package. (The 2002-03 budget package included \$203 million for equalization in 2003-04. The Governor vetoed an additional \$203 million that had been provided for "pre-SB 727" equalization.)

Categorical Programs Across-the-Board Reduction

The budget proposes additional across-the-board reductions of 1.28 percent in 2003-04. These reductions apply to most categorical programs and would be in addition to the reductions proposed for 2002-03. Programs exempt from the additional reductions include special education, supplemental instruction, child nutrition, child development, and K-3 class size

reduction. For special education, supplemental instruction, and child nutrition, the budget restores funding eliminated in 2002-03 for purposes of calculating the 2003-04 amount.

The budget proposes to apply the 3.66 percent reduction to programs that did not receive reductions in 2002-03 because their appropriations were deferred to 2003-04.

The budget funds growth for special education but not for any other categorical programs. It does not provide any funds for cost-of-living adjustments.

Categorical Block Grant

The budget consolidates funding for 64 categorical programs into a block grant. Programs exempt from the consolidation proposal include: special education, supplemental instruction, child nutrition, child development, K–3 class size reduction, immediate intervention/underperforming schools, high priority schools, math and reading professional development, principal training, and year round education. Some other programs operated through contracts are not included in the block grant such as California School Information Services (CSIS) and testing programs.

According to the proposed language in the budget bill, block grant funds may be used for “professional development, instructional materials and technology, specialized and targeted instruction programs, school safety, or for any program meeting the purposes of this provision including for those previously funded by the following Budget Act items...” School districts subject to court orders related to desegregation must first use the funds for this purpose. School districts also must comply with commitments made under the National Board Certification Incentives Program.

Funds would be allocated to school districts based on 2003-04 average daily attendance (ADA) and the aggregate amount provided under the various categorical programs in 2002-03 per unit of ADA.

Child Development Realignment

The budget proposes to transfer responsibility for child development programs, excluding state preschool programs (\$314.2 million) and after school education and safety programs (\$107.3 million), from the state to counties. Counties would receive a dedicated funding source to pay for the services. The new revenues are from a 1-cent increase in the sales tax, an increase of \$1.10 per pack in the cigarette tax, and additional tax brackets for high-income taxpayers.

Although the budget proposes to eliminate the CalWORKs program in the current year, funds sufficient to fully fund the program in 2003-04 are shown in the budget as available to counties for their use in operating child development programs.

Other Proposals

In other proposals, the budget:

- Fully funds the four programs subject to deferrals from previous years (home-to school transportation, supplemental grants, school improvement, and targeted instructional improvement grants) and does not propose any new deferrals.
- Proposes to phase out year round education operating grants over a five-year period.
- Proposes increased funding of \$27.5 million for principal training.

Next Steps in the Process

Legislative hearings on the current-year proposals have already begun. Legislative hearings on the budget year (2003-04) traditionally begin in March. In May, the Governor's Department of Finance will issue its traditional "May Revision" of population, revenue, and expenditure projections, and growth and COLA estimates are subject to change at that time. The budget bills, having been amended in each house, will be reconciled by a joint conference committee and should be passed to the Governor in late June. Upon receiving the final Budget Bill, the Governor may then exercise his line-item veto before signing the Budget Act of 2003.

As always, if you have any questions or ideas, please call me at (916) 319-0800, or my budget staff in the Fiscal and Administrative Services Division at (916) 445-0541.

NOTICE:

The guidance in this bulletin is not binding on local education agencies or other entities. Except for the statutes, regulations, and court decisions that are referenced herein, this bulletin is exemplary, and compliance with it is not mandatory. (See Education Code Section 33308.5.)

APPENDIX

K-12 Budget Changes 2002-03 and 2003-04

| | 2002-03 Revised vs. 2002-03 Enacted | 2003-04 Proposed vs. 2002-03 Revised |
|--|---|--|
| K-12 PROPOSITION 98 | | |
| Categorical block grant | | (\$5,142,451) |
| Child development | | |
| Realignment | | -967,660 |
| CalWORKs Stage 3 elimination | -\$98,806 | 98,806 |
| CalWORKs shift to federal funds | -78,269 | 78,269 |
| CalWORKs savings | -10,000 | 10,000 |
| Across-the-board reductions | | |
| Categorical programs 3.66% plus 7.46% | -750,919 | |
| Categorical programs 1.28% | | -70,933 |
| Deferred programs 3.66% | | -51,354 |
| Apportionments 3.66% | -612,354 | |
| Basic aid districts 2.15% | -15,250 | -2,571 |
| Special education | -21,004 | 42,008 |
| Supplemental instruction base | | 16,468 |
| Child nutrition base | | 2,623 |
| Other reductions | | |
| High priority schools | -22,649 | 5,849 |
| Healthy start | -2,000 | |
| CSIS new cohort | -1,576 | -5,225 |
| Instructional materials | | -145,775 |
| Governor's performance awards | | -77,000 |
| Immediate intervention/underperforming schools | | -59,967 |
| Year round education phase-out | | -18,759 |
| Early mental health | | -14,451 |
| Supplemental instruction cap | | -12,900 |
| ROC/P ADA under age 16 | | -12,000 |
| Charter school facilities | | -6,634 |
| Other | -1,098 | -3,455 |
| Funding shifts | | |
| Regional Occupational Centers/Programs (ROC/Ps) fund shift | -356,810 | 356,810 |
| Adult education | -81,145 | 81,145 |
| Federal offset for special education | | -115,805 |
| Forward funding | | |
| ARTS WORK | -5,780 | 5,780 |

| | | |
|--|---------------------|------------------|
| College preparation partnership | -5,000 | 5,000 |
| Academic improvement | -5,000 | 5,000 |
| School safety plans | -2,890 | 2,890 |
| Intersegmental programs | -1,949 | 1,949 |
| AP fee waiver | -1,445 | 1,445 |
| Principal training | -5,000 | 27,500 |
| Adult education audit findings | -13,540 | |
| Equalization | | 250,000 |
| PERS 9.5% rate increase | | 381,679 |
| Property tax proposals | | |
| Redevelopment agency shifts | -477,169 | 477,169 |
| ROC/P excess property taxes | -11,414 | -576 |
| School district excess property taxes | | -126,244 |
| Growth | | |
| Apportionments | | 321,480 |
| Special education | | 37,166 |
| Set-aside | -132,221 | |
| Deferrals | | |
| 2001-02 deferrals paid in 2002-03 | | -931,303 |
| 2002-03 deferrals paid in 2003-04 | | 681,000 |
| Base for deferred programs | | 681,000 |
| Baseline/technical | | |
| Apportionments | 389,924 | -1,025,441 |
| Property tax income | 121,168 | 676,752 |
| After school programs | -3,889 | 3,889 |
| Adults in correctional facilities | -3,000 | -200 |
| Community day schools | -10,000 | |
| High risk youth | -7,000 | |
| Special education property tax | -22,300 | -1,322 |
| Special education base | | 20,171 |
| Special education deficiency | | 8,990 |
| Other | 1,134 | -3,566 |
| Subtotal | -\$2,247,251 | \$627,697 |
| ONE-TIME FUNDS | | |
| Regional Occupational Centers/Programs (ROC/Ps) fund shift | 356,810 | |
| Adult education fund shift | 81,145 | |
| Mathematics and reading professional development | | -31,728 |
| Other | | -32,618 |
| Subtotal | \$437,955 | -\$64,346 |
| TOTAL | -\$1,809,296 | \$563,351 |